

How to overcome pension fund liabilities

William Grobel of brand valuation consultancy Intangible Business explains how established intangible valuation techniques can be used to secure pension funds against financial instability.



Key points

- ▶ It is in the interest of pension fund trustees to maintain the liquidity of companies.
- ▶ Valuing intangible assets can strengthen a company's balance sheet and provide reassurance to trustees.
- ▶ Pension funds taking security over or acquiring intangible assets can help protect the company from insolvency, thereby maintaining ongoing contributions.
- ▶ With so many pension funds in deficit, now is a good time to try and apply existing methods in new ways.

Companies are facing increasing difficulties meeting their pension obligations. If the firm cannot demonstrate a sufficiently robust covenant and is unable to meet these obligations, the pension scheme trustees may be forced into considering placing the company into administration, potentially starving the scheme of future income in the process.

Likewise, pension funds are also struggling to bridge their deficits as investment values fall and commitments rise. Pension funds are largely dependent on the liquidity of the company they are attached to. As an unsecured creditor, if the company falls into administration the pension fund is likely to be exposed to a significant loss, thus perpetuating the deficit. It is therefore in the interest of pension fund trustees to maintain the liquidity of the company to ensure continued contributions.

An innovative solution to these challenges can be found in an asset class whose value may not currently be recognised: intangible assets.

Option 1: Valuing intangibles for employer covenant assessments

Employer covenant assessments are designed to communicate to pension fund trustees a company's ability to meet its ongoing pension obligations. The balance sheet is a big part of this yet one of the main assets is generally ignored. Only intangible assets which have been acquired since 2005 by public companies will be found on balance sheets, and these at historical values.

Most companies have valuable intangible assets; brands, copyright, patents, software, design rights or contracts. These are often a company's most valuable asset and could be valued and included as part of the employer covenant assessment to support and strengthen the company's balance sheet.

Valuing intangible assets for employer covenant assessments follows the same general process as indicated by the International Financial Reporting Standard on Business Combinations, IFRS 3. This relatively standardised approach would provide reassurance to trustees that accepted methodologies have been applied. In addition, the trustees are likely to be interested in how these assets can be realised. The valuation would also provide the value of the intangible in a distressed situation, identifying the market for buyers and process for realising the value. Ongoing monitoring, including benchmarking against market comparables, could also be an important factor of this process.

Including intangibles as part of the covenant review would enable company management to give a complete picture of the company's health, providing more reassurance to trustees.

30 Mar 09

Option 2: Securitise pension funds or acquire intangible assets

Pension funds taking security over or acquiring intangible assets solves two problems. The first is that, as an unsecured creditor, the pension fund is vulnerable if the company goes into administration. The second is that lack of cash flow is the main reason companies go into administration and securitising and/or acquiring intangibles could involve a cash injection from the pension fund to the company.

Securitising intangible assets is nothing new. Pension funds taking security over intangible assets is a new idea but one which could provide much needed support at this time when cash is hard to come by. The premise is that the pension fund secures the company's brand and related intangible assets, giving the company cash to improve business operations. This arrangement could be structured in a number of different ways; the company could pay royalties to the pension fund for using the brand; the brand and intangible assets could be returned to company ownership following full repayment of the original investment; the brand or intangible asset could be placed in a special vehicle, inviting investment from beyond the pension fund; the trustees could take security of the brand in lieu of pension contributions; or a combination of these structures could be explored.

By the pension fund securitising the brand or intangible assets, it becomes a secured, preferential creditor and also helps protect the company from insolvency, thereby maintaining ongoing contributions. Company management also benefits by protecting its own pension fund, raising much needed cash, and keeping relative control of its brand by seeking finance from an investor with the company's best interest at heart.

TPR comments

In its February statement to employers sponsoring defined benefit pension schemes, the Pension Regulator (TPR), seemed open to new ideas such as this. It highlighted the potential for trustees and employers to renegotiate previously agreed recovery plans, providing scope to recognising intangibles. It drew attention to the vulnerability of pension funds being unsecured creditors, thus opening up the option of becoming secured creditors by taking ownership or control of brands and other intangible assets. It also said it will continue to 'apply the flexibilities in the system pragmatically', which opens the door for new ideas such as this.

Conclusion

The ideas behind these two solutions for struggling companies and vulnerable pension funds are new only in the world of pensions. Intangible valuation techniques are already used widely and securitising intangible assets is a familiar activity. Applying existing techniques to new markets helps prove the adage that necessity is the mother of invention. With so many companies now struggling and so many pension funds in deficit, there is no better time for well established techniques to be deployed in a new way.

www.intangiblebusiness.com
Tel: 0870 240 7386

William Grobel is director of Intangible Business.